

Rating Update: [Hamilton \(County of\) OH](#)

MOODY'S CONFIRMS Aa2 ON HAMILTON COUNTY'S (OH) GENERAL OBLIGATION DEBT AND ASSIGNS A NEGATIVE OUTLOOK; REMOVES RATINGS FROM WATCHLIST FOR DOWNGRADE

Aa2 RATING AND NEGATIVE OUTLOOK AFFECTS \$115.9 MILLION OF DEBT OUTSTANDING

County
OH

Opinion

NEW YORK, May 14, 2008 -- Moody's Investors Service confirms the Aa2 rating and assigns a negative outlook to Hamilton County's (OH) outstanding general obligation limited and unlimited tax debt. The county has a total of \$115.9 million of general obligation limited and unlimited tax debt outstanding, including special assessment debt. The lack of rating distinction between the unlimited tax and limited tax debt reflects the county's strong credit profile, non ad valorem support for debt service, and available margin under the ten-mill limitation. The ratings have been removed from watchlist for possible downgrade.

The Aa2 rating is based on the county's diverse and substantial local economy that Moody's believes will continue to exhibit long-term stability; satisfactory financial operations supported by historically healthy reserves that have been drawn down by expenditure pressures in recent years; and a manageable debt profile. The negative outlook is based on the narrowed General Fund reserve levels, the county's adopted fund balance policy, and expected continued budgetary challenges that may limit the county's ability to make significant progress toward financial goals within a timely fashion.

LOCAL ECONOMY EXPECTED TO REMAIN RELATIVELY STABLE DESPITE CHALLENGES

Moody's believes that the county's tax base, anchored by the City of Cincinnati (general obligation rated Aa1) and a relatively diverse local economy anchored by corporate employers as well as higher education and government, will remain relatively stable, despite redevelopment challenges. Demographic trends continue to stagnate in the downtown area as exhibited by historically declining population that has recently exhibited signs of stabilizing as downtown residential development continues. The county benefits from the presence of many long-standing employers within and around the City of Cincinnati including the headquarter operations of several Fortune 500 corporations, including Procter and Gamble, Kroger, Fifth Third Bank, and Macy's. Other institutional entities in the county include the U.S. government, the University of Cincinnati, and well-established health care providers, further stabilizing the core economic base. Growth is largely occurring in the neighboring Northern Kentucky region, as well as the growing metropolitan area between Cincinnati and Dayton (GO rated A1), which lie largely outside of the county's borders, although increased development is occurring within the county as well, particularly in areas toward the Indiana border where there is an abundance of available land. Growth trends in and around the county reflect the vitality of the regional economy as a whole. Regional development is also expected to benefit from concentrated redevelopment efforts within the city core.

Unemployment figures remain lower than the state and tend to approximate national figures, with 2006 annual unemployment at 5.0%, compared to 5.5% and 4.6% at the state and national levels, respectively. May 2008 unemployment figures are 4.8% for the county and 6.0% for the state. Resident incomes exceed state levels, with median family and per capita income at 107% and 115% of the state as of the 2000 census and a healthy full value per capita exceeding \$76,000.

CONTINUED DELAY IN RELEASE OF UPDATED AUDITS FOR FISCAL YEARS 2004 THROUGH 2007 DUE TO REVIEW BY STATE AUDITOR POSES A MEASURE OF RISK

Moody's believes the county's financial operations are well-managed, and will remain sound going forward despite current budgetary pressures, based upon the county's maintenance of healthy liquidity and retained budgetary flexibility. The county released a disclosure statement on October 5, 2006 attributing the delay in filing of its FY2004 and FY2005 audits to independent audit reports from the State Auditor and the Ohio Department of Job and Family Services for the periods of July 1, 2000 through June 30, 2004 and July 1, 2001 through June 30, 2004, respectively, questioning accounting and management practices of the county's social service programs. The accounting practices relate to \$2 billion of expenditures for various social service programs throughout the period in question, but the dollar amount subject to recovery has not yet been determined. The state audit reports do not allege fraud or criminal conduct. The county has released an

independent forensic audit to the state to address the issues posed by the state and is currently waiting for a response. The county's independent auditors have indicated they will not release any of the county's audits until the entire issue has been resolved. Moody's recognizes that the potential outcome and findings for recovery may pose a challenge to the county and will evaluate eventual outcomes as they are determined in the context of the county's options to comply and respond to those findings.

BUDGETARY-BASIS FINANCIAL RESULTS INDICATE PRESSURES IN RECENT YEARS

The most recent audited results in FY2003 reported a General Fund unreserved balance of \$49 million, or a healthy 20% of General Fund revenues. The total fund balance stood at a stronger \$95 million. While comparative fund balances are not available for subsequent fiscal years, the county's budgetary results provide for a reasonable proxy to track financial health. Through FY2005, the General Fund unencumbered reserve on a budgetary basis remained stable at approximately \$30 million. While audited results on a GAAP basis may show some variance once reports are available, Moody's believes that budgetary results provide a reasonable indicator of financial position in those years. In FY2006, the county's financial position declined sharply to \$19.0 million of unencumbered General Fund reserves, related to unexpected and planned one-time expenditures. These unbudgeted and planned one-time expenditures include \$4.5 million for a legal settlement, \$3.7 million to house county inmates with a neighboring county, and a \$2.1 million one-time investment in election machine upgrades. The decision to apply reserves to the inmate housing agreement was based on the expectation that a new 1/2 cent sales tax would generate revenues to replenish reserves as well as fund related public safety expenditures going forward. However, following repeated attempts to gain voter support for the new sales tax, the county made the decision to discontinue funding of the public safety programs and begin to seek alternatives. In the interim, however, the costs expended in FY2006 and FY2007 had a \$12 million negative impact on General Fund reserves.

As a result of immediate program cuts following the most recent failed voter referendum for the sales tax in November 2007 and specific actions to shore up liquidity, including the securitization of previously cash-funded expenditures, the FY2007 cash reserves remained relatively stable from FY2006 at \$18.8 million, or a relatively modest 7.6% of General Fund revenues. Current projections for FY2008 indicate a further drop in reserves to \$12.6 million, or a limited 4.8% of General Fund revenues. Moody's believes that further deterioration of liquidity would severely limit future operations and would be inconsistent with the county's current rating level.

Favorably, county management, with the support of its elected officials, has implemented key policies to address the county's narrowing liquidity and have set specific goals to restore reserves to healthier levels. In September 2007, county commissioners enacted a fund balance policy setting a goal of building a budgetary reserve equivalent to 15% of the current year's operating budget, and a commitment to increase the fund balance by at least ½% each year until the goal is achieved. Moody's notes that the enactment of an official policy and plan is important, but that it will be critical for the county to successfully achieve its goals within a timely fashion. While the county remains committed to its policy and is considering proposals that would rebuild General Fund reserves to the 15% target by 2010, Moody's considers the inability to budget for the ½% increase in FY2008 an indication that there are significant challenges remaining that could prevent the county from achieving any progress toward its financial targets.

In general, the county has undertaken a broad strategic initiative targeting key financial challenges, including frequent monitoring of budget to actual financial performance and a commitment to making adjustments to insure financial targets are achieved. To date, significant cost reductions have been made including cuts to personnel counts, wage freezes, and review of general purchases. While no broad revenue sources have been increased, the county has implemented some new fees and is also looking to maximize one-time revenue opportunities, including the sale of county assets.

Moody's notes that the county does retain a measure of additional revenue generating flexibility through permissive taxes not yet levied by the county that can be implemented without voter approval. While the failed referendum votes for the ½% sales tax increase in 2006 and 2007 may reflect persistent voter resistance to broad-based tax increases and pose political challenges to revenue growth strategies, the county continues to review all of its options. Increased communication with the community may help define a consensus strategy to helping the county reach its goal of structural balance.

The county faces the additional financial challenge posed by an economically sensitive primary revenue source. The largest single General Fund revenue source is the county sales tax, which comprised 25.3% of FY2003 General Fund revenues. Sales tax revenues have averaged an extremely modest 1.9% average annual growth from 2002 through 2007, considerably less than the 7.4% average annual growth experienced in the previous three decades. Sales tax collections improved slightly in FY2007, with approximately 3.6% growth. However, given general economic conditions, the county has budgeted more conservatively going forward, projecting a 1.5% annual increase; year to date collections are just slightly lagging budget. Moody's believes that this revenue source will continue to be challenged as regional retail growth is increasingly located in more suburban counties, but may benefit from downtown redevelopment as those efforts begin to take root. Given the county's reliance on these revenues, the need to replenish and maintain adequate reserves to absorb potential revenue stagnation is even more important.

SUBSTANTIAL TAX BASE SUPPORTS MODERATE DEBT BURDEN

Moody's expects the county's debt position will remain manageable given a debt burden that is a slightly above average at 3.6% of estimated full valuation, relatively modest future borrowing needs, and steady growth in the county's sizeable \$60.3 billion tax base. The county's debt burden primarily represents the debt of overlapping entities, as direct debt levels for the county are more moderate, yet still above average 1.2%. The county does have a significant amount of sales tax revenue bonds, secured by a dedicated half-cent sales tax. Approximately \$20 million is outstanding under the senior lien (rated Aa3), and \$571 million subordinate lien (rated A2). The county has plans to issue approximately \$10 million of General Obligation bonds in 2008, including up to \$8 million to repay the county for costs related to a legal settlement. No major capital needs are expected to require significant additional bonding for the near term.

Outlook

The county's negative outlook is based on the narrowed General Fund reserve levels, the county's adopted policy to rebuild reserves, and expected continued budgetary challenges that may limit the county's ability to achieve financial goals in a reasonable timeframe.

What would change the rating UP (outlook revision to stable)-

- Demonstrated commitment to adhering to newly implemented fiscal policies and procedures
- Measurable progress towards rebuilding reserves in a timely fashion
- Ability to achieve sustainable structural balance for the long-term, with limited dependence on one-time revenue sources and unsustainable expenditure reductions

What would change the rating DOWN-

- Continued downward trends in the General Fund financial position
- Evidence of reduced fiscal oversight and management, including deterioration of financial reporting, exacerbated by the lack of audited financial results
- Inability to address service needs, particularly related to public safety, within existing budgetary constraints

KEY STATISTICS

2000 Census Population: 845,303 (-2.4% since 1990)

2007 Estimated Full Value: \$60.3 billion

2007 Estimated full value per capita: \$74,803

2000 Per capita income: \$24,053 (114.5% of State)

2000 Median family income: \$53,449 (106.8% of State)

Direct Debt Burden: 1.2%

Debt Burden: 3.6%

Payout of principal ten years (general obligation debt): 83.5%

FY2003 General Fund Balance: \$95.504 million (40.1% of General Fund revenues)

FY2003 Undesignated General Fund Balance: \$49.020 million (20.6% of General Fund revenues)

FY2003 General Fund unencumbered reserve (unaudited, budgetary basis): \$29.5 million

FY2006 General Fund unencumbered reserve (unaudited, budgetary basis): \$19 million

FY2007 General Fund unencumbered reserve (unaudited, budgetary basis): \$19 million

Total GOULT and GOLT debt outstanding: \$115.9 million, including special assessment bonds

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